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No. 04-786

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

GLENDALE FEDERAL BANK, FSB

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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The government continues to believe that the damages issues raised in the petition for certiorari are fact-bound and not of sufficient general importance to warrant this Court's review. If, however, the Court were to decide to grant the petition for certiorari, then the Court should also grant the cross-petition. If the Court reviews the decision below at all, it should have the opportunity to review the entirety of the damages award—not merely Glendale's claim for an enormous additional damages award, but also the serious errors the court of appeals made in affirming the $381 million "wounded bank" damage award that Glendale did obtain.

Glendale urges the Court to grant its petition, but not the government's cross-petition, by asserting that the court of appeals "chastised the government for 'arguing extreme positions' in *Winstar* cases, resulting in seemingly 'endless litigation.'" Br. in Opp. 6 (quoting 04-626 Pet. App. 9a). The use of this quotation is quite misleading. First, the court of appeals in the cited passage does not refer to any of the positions the government has urged in its cross-petition. Those positions are based on settled legal principles and on legal conclusions that follow directly from factual determinations made by the courts below; they are in no sense "extreme."

More important, what the court actually said was: "It would benefit the thrifts *and* the Government, since it is not in the interest of either to have endless litigation, for *both* to stop arguing extreme positions and promptly resolve these cases in a fair and even-handed manner." 04-626 Pet. App. 9a (emphases added). The full quotation does not support the grant of Glendale's petition.

I. THE COURTS BELOW MADE THE FINDINGS NECESSARY TO ESTABLISH THE GOVERNMENT'S SPECIAL PLEA IN FRAUD, BUT NEGLECTED TO DRAW THE PROPER CONCLUSIONS FROM THOSE FINDINGS

1. Under 28 U.S.C. 2514, Glendale forfeits its entire claim if it "corruptly practice[d] or attempt[ed] to practice any fraud against the United States in the proof, statement, establishment, or allowance" of that claim. Glendale argues (Br. in Opp. 10-11) that the court of appeals correctly required proof of fraud by "clear and convincing" evidence, because a finding of fraud would result in the loss of Glendale's entire claim, not merely that part of it infected with the fraud. This Court's precedents do indeed suggest that a "clear and convincing" standard is appropriate "where particularly important individual interests or rights are at stake"—such as "terminat[ing] parental rights," "involuntary commitment proceeding[s]," or "deportation." *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 389 (1983). But no such extraordinary liberty interest is at stake here, and the Court's cases have also made clear that "imposition of even severe civil sanctions that do not implicate such interests has been permitted after proof by a preponderance of the evidence," including in cases in which the penalty for fraud includes "an order permanently barring an individual from practicing his profession." *Id.* at 389-390. As was true of the statute at issue in *Grogan* v. *Garner*, 498 U.S. 279 (1991), "the language of [Section 2514] does not prescribe the standard of proof," and such "silence is inconsistent with the view that Congress intended to require a special, heightened

standard of proof." *Id.* at 286. The court of appeals erred in requiring a higher standard of proof for fraud.

2. The courts below made all of the factual findings necessary to establish fraud by Glendale, but they erred in failing to draw the only permissible legal conclusion from those facts: that Section 2514 bars Glendale's claims. Glendale's theory of expectation damages was that it would have made a $1.6 billion profit on the additional amount that it would have been able to acquire and invest had there been no breach. See Cross-Pet. 4, 12-13; 04-626 Pet. App. 45a. At the time of the breach, however, Glendale's profits came largely from high-risk loans. In the early 1990s, when it still looked as if such loans would be profitable, Glendale's officers submitted sworn affidavits supporting its claim for damages stating that the breach caused it to "cease originating" such high-risk loans as a result of the breach and to "sell off millions of dollars of loans in high risk-weighted categories." Cross-Pet. 14-15 (quoting affidavits). Later, changes in market conditions made it apparent that high-risk loans would have resulted in huge losses, not high returns. Therefore, by the time of trial, Glendale's officers were testifying that the breach cost them money because it prevented them from investing in *low*-risk assets, which under then-prevailing market conditions would have been profitable. See *id.* at 17-18 (quoting trial testimony).

Glendale's principal defense of the decision below on the fraud issue is that the two sets of statements were not really inconsistent. See Br. in Opp. 11-12, 15. The trial court, however, rejected that argument, finding that Glendale's earlier statements "are *not consistent* with statements made by [Glendale's officers] during trial." 04-626 Pet. App. 55a (emphasis added); see *ibid.* ("inconsistencies"), 56a ("discrepancies"); see also *id.* at 29a (court of appeals' reference to Glendale's "conflicting statements," to "conflict in the testimonies," and to trial court's finding that statements were "not consistent"). Glendale also argues (Br. in Opp. 14-15)

that the statements were mere "opinions" and not factual assertions. But Glendale's officers were not qualified to give opinion testimony under Federal Rule of Evidence 702, and, as the above-quoted statement demonstrates, the trial court correctly understood that the question of Glendale's investment plans—the question of how much, if any, profits Glendale would have made without the breach—was a question of fact. See also 04-626 Pet. App. 56a (earlier statements "seriously challenge the credibility of plaintiff's trial testimony" and Glendale's later statements "not credible"). Finally, Glendale continues to argue that its later accounts were correct. See Br. in Opp. 14-15. But the trial court found otherwise. See 04-626 Pet. App. 56a (stating that it is "particularly clear" that "Glendale believed at the time [of the breach] that it should continue to invest in higher risk-weighted lines of business").[1]

The conflicting statements could not have been mere mistakes. Because Glendale was describing its own business intentions, a subject upon which it is the foremost authority, its false statements must have been made knowingly. The courts below nonetheless absolved Glendale of the consequences of having made those statements on the ground of "hindsight." That may explain the shift of positions, but it

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[1] Glendale also argues that in their earlier sworn statements, Glendale's witnesses "didn't ask" themselves whether they would have exited the high-risk lines of business absent the breach. See Br. in Opp. 13. The trial court correctly rejected Glendale's argument, because the executives answered that question in the most emphatic manner possible; they explained that exiting high risk lending was "unthinkable—and would not have occurred—but for the government's breach of contract." 99-5103 C.A. App. A3000052. Moreover, government trial attorneys repeatedly inquired whether, during 1991-1993, non-breach factors, Br. in Opp. 13-15, were relevant to Glendale's decision to exit high-risk assets. See, *e.g.*, *id.* at A4000062, A4000076-77, A4000118-19, A4000750. In response, Glendale insisted that it had accurately "forecast where [Glendale] would have been *but for the government's breach.*" *Id.* at A3000079 n.34 (emphasis added).

should not excuse it. If this Court grants the petition for certiorari, it should consider the question whether Section 2514 precludes Glendale's recovery.

II. THE JUDGMENT IN FAVOR OF GLENDALE WAS INFECTED BY A FAILURE TO REQUIRE AFFIRMATIVE PROOF OF DAMAGES

As demonstrated in the conditional cross-petition (Cross-Pet. 25), the court of appeals erred in relieving Glendale of its obligation to present affirmative evidence supporting its $381 million "wounded bank" claim.

1. Glendale incorrectly contends (Br. in Opp. 15) that the cross-petition requests that this Court review a "record-intensive, factbound question subject to a highly deferential standard of review" with respect to the wounded bank award. In fact, the lower courts found all relevant facts against Glendale.

As noted above, the trial court rejected Glendale's contention that, in the absence of the breach, it would have exited higher-risk lending and would have invested instead in low-risk assets. See 04-626 Pet. App. 55a-56a. So did the court of appeals. See *id.* at 27a (breach-induced shrinkage "reduced [Glendale's] losses"); see also Cross-Pet. 5-6, 22 (continued investment in high-risk assets would have been disastrous). Thus, there was no evidence in the record to support the claim that, in the absence of the breach, Glendale would have remained in capital compliance, and hence no basis upon which to conclude that the breach caused Glendale to fall from capital compliance. That gap in proof should have precluded an award of "wounded bank" damages. The cross-petition thus does not request that this Court review the lower courts' factual findings, but rather requests that Glendale be held to the same requirements of proof as any other breach-of-contract plaintiff, a classic legal issue.[2]

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[2] For the same reason, Glendale's invocation of this Court's "two-court rule" (Br. in Opp. 24) is mistaken. That rule does not limit review by the

2. Glendale erroneously contends (Br. in Opp. 16-17, 21) that, because it categorized its wounded bank claim as one for reliance damages, it did not bear the burden of proving that the breach caused it to fall from capital compliance. That is mistaken. However categorized, the plaintiff has the burden of proving that the breach caused it the damages it claims. See 04-626 Pet. App. 6a ("focus of a recovery" for "reliance interest" is "costs * * * that the thrift would not have incurred but for the contract and its subsequent breach"); *id.* at 36a (similar); accord *Lifewise Master Funding* v. *Telebank*, 374 F.3d 917, 933 (10th Cir. 2004) ("In order to recover reliance damages for breach of contract, the plaintiff must demonstrate with certainty that * * * damages have been caused by the breach."); Restatement (Second) of Contracts § 346 (2) (1981) ("If the breach caused no loss or if the amount of the loss is not proved," nominal damages are awarded.). Despite its correct articulation of Glendale's burden, however, the Federal Circuit did not hold Glendale to that standard, for Glendale submitted no evidence (aside from its rejected lost profits claim) that the breach caused it to fall from capital compliance.

Glendale's argument that the government bore the burden of proving that the breach did not cause Glendale to fall from capital compliance, an argument that was not accepted by the courts below, appears to stem from a misreading of the so-called "losing contract" defense to reliance damages. That doctrine permits a defendant, once a plaintiff has demonstrated that a breach caused it to incur reliance damages, to reduce damages by showing that, even in the absence of the breach, full performance of the contract would have produced a loss. *United States* v. *Behan*, 110 U.S. 338, 343-347 (1884); 3 E. Allan Farnsworth, *Farnsworth on Contracts*

Court in cases such as this, in which two courts have awarded damages to a plaintiff despite their rejection of the plaintiff's only evidence supporting its request for damages.

§ 12.16, at 282 (3d ed. 2004); Restatement, *supra*, § 349 & cmt. a. The doctrine is inapplicable here, for two reasons. First, as explained above, Glendale never met its initial burden of demonstrating that the breach caused it to incur its claimed damages. Second, no party ever suggested that performance of the contract itself would have caused Glendale to fall from capital compliance, *i.e.*, that the contract was a "losing contract." Rather, the event that would have led Glendale to fall from capital compliance even in the absence of the breach—its stated intent to retain its high-risk investments—was unrelated either to the breach or to performance of the contract.

3. Glendale contends (Br. in Opp. 17) that, in awarding reliance damages, the trial court properly relied upon Glendale's expert, Dr. Horvitz. That contention is unavailing, however, because the premise of Dr. Horvitz's opinion—that the acquisition of Broward cost Glendale more than $500 million—was expressly rejected by the Federal Circuit and by the trial court on remand. 04-626 Pet. App. 35a, 37a (court of appeals); *id.* at 18a (trial court). Thus, Dr. Horvitz's opinions are insufficient to plug the evidentiary gap in Glendale's case. See Cross-Pet. 23.

Glendale also contends (Br. in Opp. 17-19) that other evidence supports its wounded bank claim. But the decisions of the courts below do not rely upon any of the items Glendale cites. Moreover, none of the items purports to show that the breach caused Glendale to fall from capital compliance.

a. Glendale argues (Br. in Opp. 17-18) that it would have maintained capital compliance in the absence of the breach, because the breach reduced Glendale's regulatory capital by an amount ($527.5 million) that was greater than the amount by which it fell out of capital compliance ($252 million). That argument, however, is inconsistent with Glendale's repeated statements and the lower courts' findings that, in the absence of the breach, Glendale would not have reduced its asset size. Pet. App. 27a; 03-5136 C.A. App. A4001564 ("[T]he

breach caused Glendale to shrink."). Because capital compliance is based upon asset size, no-breach Glendale would have needed far more than $527 million to remain in compliance. Indeed, that is why Glendale attempted to use its lost profits claim to demonstrate that it would have generated sufficient profits in the absence of the breach to maintain capital compliance. See *id.* at A1007165-67; A2002593-95, A2005024-27; see also *id.* at A1011189-94. The rejection of Glendale's lost profits claim required the rejection of its dependent wounded bank claim.

b. Glendale also contends (Br. in Opp. 18) that its pre-breach history of maintaining capital compliance, its pre-breach examination ratings, its ability to respond to changing economic conditions, and its pre-breach income, served as evidence that the breach caused it to fall from capital compliance. That evidence, even if true, was irrelevant. The trial court accepted Glendale's first set of sworn statements that the breach caused it to divest billions of dollars in high-risk assets. 04-626 Pet. App. 56a. Thus, in the absence of the breach, as the trial court found, Glendale would have suffered enormous losses from those investments.[3]

c. Finally, Glendale presents several reasons (Br. in Opp. 22-23) why it purportedly would have divested its higher-risk assets even in the absence of the breach, and, thus, avoided falling from capital compliance. The trial court, however, expressly rejected Glendale's second version of its

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[3] Glendale also relies (Br. in Opp. 21) upon a stray misstatement of a government expert, Professor Daniel Fischel, when discussing a different issue during his 30 days of testimony, to the effect that Glendale fell out of capital compliance because of lost goodwill. In fact, Professor Fischel testified that the breach saved Glendale by forcing it to divest high-risk assets and that, absent the breach, Glendale "in all likelihood" would have failed entirely. 99-5103 C.A. App. A1010573; see *id.* at A101057-79. As he explained, "[t]he phase out of supervisory goodwill, in my opinion, did not cause Glendale to become a wounded bank." 03-5136 C.A. App. A1011184, A1022000-01.

intent in the absence of the breach, concluding that "the contemporaneous affidavits suggest that Glendale believed at the time [of the breach] that it should continue to invest in higher risk-weighted lines of business." 04-626 Pet. App. 56a. Ultimately, the courts below erred in simply accepting on faith Glendale's premise that it would have remained in capital compliance—and not suffered "wounded bank" damages—in the absence of the breach. That is an insufficient basis for an award of $381 million.

III. GLENDALE'S DAMAGES AWARD WAS SUBJECT TO A $243 MILLION OFFSET

The cross-petition demonstrates (Cross-Pet. 26-27) that, even if an award of some wounded bank damages were proper, the lower courts should have deducted from that award the $243 million premium Glendale received when it sold Broward. Because a significant portion of the wounded bank damages awarded to Glendale was based on the premise that the breach caused it to sell Broward and thereby incur a higher cost of funds, a damages award that did not account for the benefits Glendale received when it sold Broward violates the fundamental principle that a breach of contract plaintiff should not be placed in a better position through an award of damages than it would have occupied in the absence of the breach. *Miller* v. *Robertson*, 266 U.S. 243, 260 (1924).

Glendale contends (Br. in Opp. 25-26) that an offset to account for the $243 million premium it received for the Florida division would be appropriate only if Glendale were advancing a claim for expectation damages. The *Miller* v. *Robertson* principle, however, does not depend on the category of damages awarded, but on the need to avoid giving the plaintiff a windfall. See, *e.g.*, *Hi-Shear Tech. Corp.* v. *United States*, 356 F.3d 1372, 1382 (Fed. Cir. 2004). Moreover, Glendale's suggestion that the offset for the Florida premium is appropriate only in an expectation damages calcula-

tion is inconsistent with its admission in the courts below that its claim for *restitution* was subject to that same offset. See Cross-Pet. 27-28. Given the rejection in full of Glendale's restitution claim, the $243 million premium should have been offset against the reliance damage award.

Glendale also contends (Br. in Opp. 25) that the premium should not be considered because the Government did not demonstrate that "over its 13 years of ownership, Glendale received more from Florida's *assets* than it paid for Florida's *liabilities*." When a party takes an action to mitigate the effects of a breach (such as selling Broward), however, that party is entitled to its costs of mitigation (the wounded bank damages), but must also account for the benefits it receives from the mitigating transaction (the $243 million premium). *LaSalle Talman Bank* v. *United States*, 317 F.3d 1363, 1372-73 (Fed. Cir. 2003); Restatement, *supra*, § 347, cmt. e; Charles T. McCormick, *Handbook on the Law of Damages* 146 (1935). Here, Glendale accounted only for its alleged costs in selling Florida and ignored the offsetting benefit. Acceptance of that calculation was error.[4]

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For the foregoing reasons and those stated in the cross-petition, the Court should grant the cross-petition if it grants the petition for a writ of certiorari in No. 04-626.

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Acting Solicitor General

FEBRUARY 2005

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[4] Similarly, Glendale argues (Br. in Opp. 26) that its transfer of Broward for market value "does not create a gain" and therefore need not be offset against its damages. That is mistaken. The fact that Glendale received fair value when it sold its Florida deposits means that it was not damaged by that sale; it does not mean that it can be awarded damages for "wounded bank" costs stemming from the sale while ignoring the corresponding benefits.